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Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1995

Edward H. Patterson and Barbara Morley, Husband and Wife and American Central City, Inc., A Nebraska Corporation,
Petitioners,

v.

City of Lincoln. Nebraska, A Municipal Corporation,
Respondents.

On Petition for Writ of Certiorari
To The Supreme Court of Nebraska

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The City of Lincoln, Nebraska condemned an assemblage of land adjacent to the University of Nebraska. At trial, the City of Lincoln's appraisers relied on sales to establish "market value." Patterson was prevented from entering testimony based on the "net present value" ("capitalization of income") method, or in the case of development land, the "development cost" method.

1. Can "market value" be determined by relying exclusively on sales not properly adjusted for distance in time and location or differences in size or zoning, that were not arm's length transactions, and not subject to the same economic forces as the condemned property, while excluding sales, without good cause, more proximate in time and location?

2. Is the "net present value" method an appropriate technique for valuing condemned development land if it is based on a computer-spreadsheet model with concrete and verifiable input parameters?

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IN THE SUPREME COURT OF THE UNITED STATES
October Term, 1995

EDWARD H. PATTERSON and BARBARA MORLEY. Husband and Wife and AMERICAN CENTRAL CITY, INC., A Nebraska Corporation, *Petitioners*,

v.

CITY OF LINCOLN, NEBRASKA, a Municipal Corporation, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE NEBRASKA SUPREME COURT

Edward H. Patterson, Barbara Morley, and American Central City, Inc. respectfully petition for a writ of certiorari to review the judgement of the Supreme Court of Nebraska in this case.

OPINION BELOW

The opinion of the Supreme Court of Nebraska (App.A, 1-8) is reported in 250 Neb. 382, 550 N.W.2d 650 (1996).

JURISDICTIONAL STATEMENT

The judgement of the Nebraska Supreme Court was entered on June 28, 1996. The petition for writ of certiorari was filed on September 26, 1996. The court has jurisdiction over this matter pursuant to 28 U.S.C. Sec. 1257(a).

CONSTITUTIONAL PROVISIONS AT ISSUE

The federal constitutional provisions at issue in this matter are the Fifth and Fourteenth Amendments to the United States

Constitution. The Fifth Amendment provides in part: "[N]or shall private property be taken for public use without just compensation." The Fourteenth Amendment provides in part: [N]or shall any state deprive any person of life, liberty, or property, without due process of law."

STATEMENT OF THE CASE

This case is a determination of just compensation for condemned real estate located in Lincoln, Nebraska. The City of Lincoln, under its eminent domain powers, took an assemblage of land from Petitioners Edward H. Patterson, Barbara Morley, and American Central City, Inc., a Nebraska corporation. Mr. Patterson was the president and sole stockholder of American Central City, Inc. (hereafter petitioners will be referred to as "Patterson").

Mr. Patterson acquired the property lot by lot, over a period of 18 years, commencing in 1972 (22:7; 33:15-16) and culminating in June of 1988. (92:22-24) Mr. Patterson, who has a B.A. in Mathematics, an M.B.A. with a specialization in Real Estate Finance from the University of Nebraska, and coursework sufficient to complete an M.S. in Electrical Engineering, is an experienced draftsman, and a telecommunications expert, focused his real estate investment in an area adjacent to the downtown campus of the University of Nebraska. (22:19-24) His decision to be near the University campus was based on a desire for a stable real estate environment and his goal of assembling enough land for the development and construction of an office-residential building or mid-rise apartments with a telecommunications facility adjacent to and in conjunction with future development by the University of Nebraska. (28:24-25; 29:1; 54:21-25; 55:1-5) Through his own efforts, he either purchased personally, purchased at auction, by contract, or by purchase from estate or conservatorship all of the real estate involved in the condemnation action. As he acquired each of the properties, he demolished blighted houses, planted grass, and maintained the property until his goal of total assemblage was

attained. Patterson's goal was to be realized in conjunction with the development of a Research and Development Center, as specified in the 1967 University of Nebraska (UNL) campus twenty-year plan, on the adjacent property owned by University of Nebraska (hereafter referred to as the "Beadle Biotechnology Center"). The Beadle Biotechnology Center, which was under development at the time of condemnation, was not a part of the public project for which Patterson's land was condemned. In 1990, interest rates were declining to a level which would make financing conducive for development and construction. (49:20-25; 50: 1-19)

The subject property at the time of taking was zoned R-6, which allowed residential and apartment use. (117:22-23; 235:1; 294:11-12) Based on the total assemblage of land achieved by Patterson, and the zoning classification, Patterson could legally construct 218 units on the property. (120:21-23; 195:12-14; 308:15-17) Architect's plans were admitted into evidence demonstrating that 218 units was practically possible. (E9-E10) Patterson testified that his opinion of the "market value" of the property on May 25, 1990, without giving any regard to income-producing abilities of the property, was $10,000/unit. (64:18-23) When based upon the maximum number of units that the property would support (218), Mr. Patterson's opinion of value was $2,180,000.00. Mr. Patterson based this on the only other land assembly sequence done in the 1980's in the neighborhood, which terminated in 1989, prior to decreasing interest rates, with an unadjusted acquisition cost at the rate of $7,300/unit. Mr. Patterson testified that the property, which was three blocks further east of the campus, was in an inferior location to his property. (Time sequence sale analysis is covered in Appendix B under "Purchase Price Not Discounted to Time of Buildability").

Mr. Patterson also testified that he had valued the land using a "capitalization of income" method (also called the development cost approach when the land must be developed) (hereafter called the "income method"). (67:12-15) He further testified as to his expertise in being able to give an opinion as to

such an evaluation. (67:16-25; 28:1-3) When asked whether he had an opinion of the fair market value of the land as of May 25, 1990, using the income or development cost based valuation, (84:3-8), Mr. Patterson said "yes." The City of Lincoln objected to Mr. Patterson giving this opinion, and the trial court sustained the objection. (84:9-17) An offer of proof was made that Mr. Patterson's opinion of value, based on the income method, was $4,470,330. (85:4)

Patterson called two expert witnesses to give their opinion of value of the property. The first of Patterson's expert witnesses, Mr. Hassebrook, a licensed real estate appraiser, after being qualified as an expert, (E11, 107:13-18) testified that, because of the unique way the property was assembled, and the fact that 218 units could be built on the property, the value of the property was $4,000.00/unit or a total fair market value of $872,000.00. (152:3-9) Mr. Hassebrook testified that the subject property was uniquely located relative to the University of Nebraska (110:6-11), was close to the downtown area, including the State Capitol and the County-City Building (110:11-18), and access to other areas of the City was favorable. (111:6) Mr. Hassebrook further testified that the demand for apartment growth in this area was strong, particularly demand for student housing (12:10-17) and that the assemblage of property attained by Patterson ***was not comparable*** to any other assemblages in the immediate area (179:24-25; 180:1-7) and that the location was excellent. (181:15-16; 182: 14). For these reasons, he was not able to locate true comparable sales, and was forced to use sales that were distant in location and with lesser investment potential than the Patterson land to make his estimate of value based on sales, and was required to make excessive adjustments. (E15)

Mr. Hassebrook also did a rental complex survey that showed that there was in Lincoln, Nebraska a ***$100 (approximate) per month rental increment solely attributable to being near the campus***, thus demonstrating that the land had added value because of its situs near the University campus as

opposed to outlying locations. (149: 24-25; 151: 13) The City of Lincoln objected to Mr. Hassebrook's opinion using these data to enter a quantitative estimate of value of this $100 stream based on income capitalization and the trial court sustained the objection. (155:24)

Patterson's second expert, Mr. Johnson, a licensed real estate appraiser, also attempted to give an opinion to the valuation of the property using the income method. He testified that appraisers used both the income and the comparable sales methods. Mr. Johnson attempted to reach actual value by reconciling values found with each approach. The City of Lincoln objected and the trial court sustained the objection. (191:15-25) Mr. Johnson further testified to the uniqueness of the property and the ***difficulty of finding comparable sales***. (200:25; 201:1)

Appraisers for the City of Lincoln testified that the income method was inappropriate for undeveloped land, and relied exclusively on sales to determine market value. The first of the City of Lincoln's appraisers, Mr. Frost, testified that he used sales from 1981 to 1990, largely of different zoning, **none** of which were adjusted for differences in time, proximity of location, degree of assemblage, and zoning. Many were not arm's lengths transactions (E22). Mr. Frost testified that the market was flat, and he therefore did not need to adjust sales. (240:2) Patterson objected to Mr. Frost's valuation using these sales as an inappropriate measures of damages, and the trial court overruled the objection.(261:23)

The City of Lincoln's second appraiser, Mr. Matthew Wilson, testified to "market value." His sales overlapped with those of Mr. Frost, and were also not properly adjusted for time, location, zoning, degree of assemblage, etc. He testified that he omitted using the sales closest in time to the taking because his market research in the subject neighborhood was done prior to these sales being filed. (322:7-13) In other words, Mr. Wilson testified that his research for forming his opinion as to "market

value" was done approximately one year prior to the actual date of taking. Patterson objected to Mr. Wilson's opinion because it was based on an inappropriate measure of damages. The trial court overruled the objection.

The City of Lincoln's two appraisers valued the land at $1,750/unit and $1,500/unit, respectively, for a total of $381,500 and $325,000, respectively.

The City of Lincoln was also allowed, over objection, to show pictures of blighted houses that were not present at the time of the condemnation. (E23-34)

The verdict differed from market value determined by (1) Mr. Patterson to be $10,000 based on the only other land assembly sequence done in the 1980's in the neighborhood, terminating in 1989, prior to buildable interest rates, with unadjusted acquisition at the rate of $7,300/unit, in an inferior location three blocks east of campus; (2) Mr. Hassebrook to be $4,000/unit based on the only recent large (88 units, buildable by special permit) single parcel sale at the rate of $4,000/unit in an inferior location; (3) Mr. Hassebrook's valuation of $11,000/unit based on the capitalization of a $100/month rental increment attributable solely to the situs value of the campus border location (the opinion was not admitted into evidence); and (4) Mr. Patterson's estimate of value of $15,000 - $20,000/unit based on a computer spreadsheet, net present value analysis of fully bid, professionally stamped architect's plans over a range of amenities and rent levels (opinion not admitted into evidence; offer of proof made).

The verdict also differed from an independent study done in 1977 by Luedke and Associates (E20) commissioned by the City of Lincoln Urban Development Department that stated that land in the area, including Patterson's land, was selling for $3,000 - $3,500/unit in 1977. The Luedke report advised the City of Lincoln that its acquisition costs for land comprising a section

that included approximately **one-half** of Patterson's land would have been $492,000 **in 1977.** (E20)

PROCEEDINGS BELOW

Patterson appealed the verdict to the Nebraska Appeals Court, and the Nebraska Supreme Court took the case of its own accord. The Nebraska Supreme Court affirmed the jury verdict.

The Nebraska Supreme Court concluded that the sales used by the City of Lincoln's appraiser, Mr. Frost, were competent evidence because:

> He adjusted each comparable sale to minimize the differences between it and the condemned property. He explained each adjustment. He also, where he thought it appropriate, adjusted each comparable sale price to simulate the market conditions at the time of the condemnation of Patterson's property. These adjustments were explained.

Patterson v. City of Lincoln, 550 N.W.2d 650, 653 (Neb. 1996). The court further concluded that Patterson' experts had also used sales, and that was evidence that there were, in fact, "comparable" sales, and that the land had no "intrinsic value."

The court did not discuss the evidence, presented at trial and discussed in Appellant's brief and at oral argument, that neither of the City's appraisers properly adjusted the sales. Dates were not included in their exhibits until cross-examination (E22, E39) Mr. Wilson admitted that he did his appraisal in 1989. (248: 7-13) The court did not address the testimony by Patterson's expert Mr. Hassebrook that there were ***no comparable sales*** and that there was only one sale that was reasonable enough to use in his market data approach, without extremely large adjustments (E16). The court did not address the issue, raised at trial, in Appellant's brief to the court, and at oral argument, that the City of Lincoln's appraisers omitted the

most recent sales and Patterson was deprived of his right to just compensation at the time of taking.

With respect to "intrinsic value," the court did not discuss why the study done by Patterson's expert, Mr. Hassebrook (149: 24-25; 151: 13), demonstrating increasing rents in apartment complexes as distance to the university campus decreased, did not demonstrate that the land had "intrinsic value" due to its situs. This issue was raised in Appellant's brief to the court and at oral argument.

HOW THE FEDERAL QUESTION WAS PRESENTED

Patterson appealed the case to the Nebraska Supreme Court on the basis of the Fifth Amendment Just Compensation Clause as applied to the states through the Fourteenth Amendment. The constitutional issue was clearly stated. In discussing the first proposition, the constitutional standards and the "willing buyers and sellers" and the "make whole" principles were stated. These same principles were raised at oral argument. The Supreme Court of Nebraska did not find that Patterson had been deprived of his constitutional right to just compensation.

REASONS FOR GRANTING THE WRIT

When property is condemned by the state, the Fifth and Fourteenth Amendments require just compensation. The United States Supreme Court has not recently addressed the issue of the "second prong" of the Just Compensation clause -- the method used to value property. This may seem like a well-answered issue, but modern methods of valuation and the susceptibility of "market value" to manipulation by the State compels a reevaluation of the issue. There are conflicting federal and state court decisions with respect to admissibility of the "capitalization of income" method of valuation to supplement or replace "market value" as determined by comparable sales. This method of valuation is also called the development cost approach where the land must be developed (hereafter referred

to as the "income method"). Additionally, the Minnesota Supreme Court and the Fourth Circuit of Appeals have admitted evidence of value based on the income method in cases that are very similar in fact, and identical in principle, to the present case.

The discrepancy among the courts in the admissibility of the income or development cost approach has arisen from two socioeconomic changes. Technological advances resulting in the widespread use of computers have made the income method more precise, while the scarcity of assembled urban land has made the "comparable sales" method for such properties more speculative.

I. Just Compensation is an Important Federal Question. The Fifth and Fourteenth Amendments Require That a Condemned Landowner be Compensated for Market Value at the Time of Taking

a. The Basic Tenet of Just Compensation is Indemnification: a Landowner Must be "Made Whole"

The basic tenet of just compensation is indemnification and arises from the basic equitable principles of fairness. *United States v. Commodities Trading Corp.*, 339 U.S. 121, 124 (1950); *United States v. Fuller*, 409 U.S. 488, 490 (1973). Compensation is 'just' if the condemnee is "made whole." *United States v. Miller*, 317 U.S. 369, 373 (1943), and the condemnee is put in as good a position pecuniarily as he would have been if his property had not been taken. *United States v. New River Collieries*, 262 U.S. 341, 345 (1923); *Olson v. United States*, 292 U.S. 246, 255 (1934); *Miller*, 317 U.S. at 373; *United States v. Reynolds*, 397 U.S. 14, 16 (1970). Compensation is ***just*** only when it is the full equivalent for the property taken. *Monongahela Navigation Co. v. United States*, 148 U.S. 312, 326 (1893) ("There can ... be no doubt that the compensation must be a full and perfect equivalent for the property taken"). The value is what the claimant lost by the taking. *New River Collieries*, 262 U.S. at 345; *United States v. Chandler-Dunbar*

Co., 299 U.S. 53, 76 (1913). One of the purposes of just compensation is to redistribute the economic loss so that it will fall upon the public rather than upon those who "happen to lie in the path of the project." *United States v. Willow River Co.*, 342 U.S. 499, 502 (1945)

Just compensation is generally determined by "market value." The true test of market value is what price will be agreed upon by a willing seller and a willing buyer neither of whom is under a compulsion to sell or buy. *Miller*, 317 U.S. at 374; *Almota Farmers Elevator & Warehouse Co. v. United States*, 409 U.S. 470, 477 (1973). The willing buyer is presumably a private citizen -- not a government bureaucrat. An eminent domain action is not a voluntary transfer of property rights, and the value therefore a well-informed guess, but market value must be the cash equivalent of the property right had a voluntary exchange taken place. *Kimball Laundry Co. v. United States*, 338 U.S. 1, 6 (1948).

b. "Market Value" Can be Determined by Comparable Sales Only When the Properties Are* In Fact *Comparable

The Supreme Court established that "market value" is often determined by comparable sales. Comparable sales are those that are sales of similar kind at about the same time. For a sale to be admissible and relevant, it must be ***in fact*** comparable. *Fairfield Gardens, Inc. v. United States*, 306 F.2d 167, 172 (9th Cir. 1962) (emphasis added). Sales that are so dissimilar to the condemned property that they cannot establish market value are not "comparable" sales. The rule is that "comparability ... does mean, at the very least, similarity in many respects." *Id.* at 173.

c. "Market Value" is Speculative and Subject to Manipulation When the Sales Used Are Not "Comparable"

When dissimilar sales are admitted to value condemned property, "market value" is speculative and subject to manipulation and abuse. The State undervalues the property taken. The use of dissimilar sales, when more appropriate sales are available, allows appraisers to "pick and choose" from lesser

valued properties and to substitute them for true comparable sales and actual value based on other accepted methods. The Just Compensation Clause is designed to limit the flexibility and freedom of governmental authorities. *First English Evangelical Lutheran Church v. Los Angeles*, 482 U.S. 304, 321 (1987). The Just Compensation Clause requires that the State be restrained from paying less than "market value."

As a matter of law, sales distant in time, of different zoning, and of vastly different size are not "comparable." The discrepancies among the courts in what is considered acceptable, and what is not acceptable, in terms of similarity or dissimilarity is enormous, and goes beyond the broad discretion given to trial courts in such cases. There is a true controversy as to the appropriate measure of just compensation.

In the present case, the use of inappropriate properties allowed the City of Lincoln's two appraisers to testify to values of $381,500 and $325,000, respectively, for the condemned property. The only two sales that were proximate in time and location would have valued the property at ***greater than*** $2,100,000. (64: 13) Mr. Frost testified that his appraisal was independent of Mr. Wilson, the City of Lincoln's second appraiser (279:9 - 280: 16), but on cross-examination, it was shown that identical language described the properties in both appraisals.(280: 1-25; 281: 1)

A summary of the sales (E22) comprising the valuation by the City of Lincoln's appraisers, Mr. Frost and Mr. Wilson are detailed in Appendix B. In addition to the fact that the sales were ***not properly adjusted*** to the time of taking, the sales do not fulfill the requirement of the Just Compensation clause because they are not all arm's lengths transactions, are not complete sales, and are of improper zoning, including special permit developments sites, which are not sales made on the open market. An explanation of why each sale does not fulfill the Fifth Amendment requirement of just compensation is also in Appendix B.

d. When Comparable Sales Distant in Time Are Admitted, but Comparable Sales Close in Time Are Omitted, Fair Market Value Has Not Been Determined at the Time of Taking

When a condemnor's appraisers are allowed to use sales not subject to the same economic conditions as the condemned property, the market value cannot be determined by those sales. A landowner is entitled to be compensated for market value at the time of taking. If the sales used are not comparable, and sales closest in time to the taking are ignored, then the landowner is not compensated for market value at the time of taking. Sales at or near the time of taking are the most appropriate measure. *United States v. 100 Acres of Land*, 468 F.2d 1261, 1265 (1972).

Although the taking was in 1990, the city's appraisers omitted two sales in 1989 that were on the same block as an earlier, included sale. Recessionary interest rate declines and rental market adjustment for the tax reform act of 1986 were just beginning to allow major apartment construction to pick up in Lincoln. The omitted sales showed that market values had risen in 1989 and were continuing to rise in 1990, anticipating even lower interest rates and completion of the Beadle Research Center. The Beadle Research Center was not a part of the public project for which the Patterson property was taken, and Patterson was entitled to full benefit of any rising property value due to its imminent construction.

e. When The Government Knowingly Manipulates "Market Value" to Undervalue Condemned Property, it is Manifest Injustice Not to Award Actual Value

It is manifest injustice to allow a condemnor to take property at less than "market value" after sitting by and watching an individual assemble property that it's own consultant had calculated would cost more than the annual federal block grants would allow them to acquire. In 1977, the City of Lincoln Urban Development Department first became interested in acquiring property in the neighborhood surrounding the

University of Nebraska. The city hired a consulting firm, Luedke and Associates, to determine the manner and cost of acquiring the property in the area, including the land later taken from Patterson. The Luedke report (E20) stated that small parcels of assembled land in the area were selling for $3,000 - $3,500/unit in the 1970's. Contrast this with the City's appraisers' testimony; they testified that the value of the property in 1990 was only $1,750/unit and $1,500/unit, respectively, despite an average 1.5% apartment vacancy rate in the neighborhood, the lowest interest rates in two decades, and imminent completion of the neighboring multi-million dollar Beadle Biotechnology Center.

f. "Market Value" is Not an Absolute Standard or an Exclusive Method of Valuation

The Supreme Court has held that "market value" is "not an absolute standard nor an exclusive method of valuation." *United States v. Virginia Electric & Power Co.*, 365 U.S. 624, 633 (1961). The Supreme Court has recognized two important exceptions to the use of comparable sales. Other methods of determining value are appropriate when (1) the market is too difficult to find or (2) when its application would result in manifest injustice to the owner. *Miller*, 317 U.S. at 369; *Olson*, 292 U.S. at 246. In other words, market value should not be used when market value furnishes an incorrect measure of ***actual value***. *United States v. General Motors Corp.*, 323 U.S. 373, 379 (emphasis added); *United States v. 50 Acres*, 469 U.S. 24, 25 (1984) (O'Connor, S., concurring). When there are too few true comparable sales, then the prices paid (for those sales) cannot be used to predict with any assurance that the prices paid would be repeated in the sale of the now condemned property. *United States v. Toronto, Hamilton & Buffalo Navigation Co.*, 338 U.S. 396, 402 (1949).

The condemned property in the present case was zoned for 218 units and was immediately adjacent to the campus, making it a scarce and valuable resource among University cities. Plans were used at trial to show that 218 units was not only legally

permissible, but factually possible. A recently declared floodplain classification was used to Patterson's advantage by providing otherwise more than zoned clearance for below building parking.

There were no comparably sized properties in the area surrounding the university. (179:24-25; 180:1-7; 200:25; 201:1) The only assembled property was specially zoned, and on which 88 units were built. An 88-unit complex is not subject to the same ***economic factors*** affecting a 218-unit sale. Land that can support >200 unit accrues the advantages of large developments, e.g, favorable interest rates through direct placement of institutional loans and economies of scale in development cost and operating expense. A prospective buyer will consider these factors in an offering price. The fact that vacant land is not easily found in urban settings was recognized by the court in *United States v. Certain Land*, 346 F.2d 690, 691 (2nd Cir. 1965). The court in *Certain Land* concluded that smaller vacant lots, while more commonly available, are of questionable similarity and relevance. Market value of a large cleared assemblage of lots targeted at a location of unique value would necessarily reflect the assembly costs of acquisition, demolition, holding time, taxes, upkeep and predevelopment risk. There is little doubt that "willing vendees and vendors would deem such information relevant." *Id.* at 694.

g. There are Three Ways to Value Property

1. The current cost of reproducing a property less depreciation from all sources, that is, deterioration and functional and economic obsolescence.
2. The value which the property's net earning power will support, based upon a capitalization of net income.
3. The value indicated by recent sales of comparable properties in the market.

...

In the majority of his assignments, the appraiser ... will use all three as a check against each and to test his own judgment. The use of all three approaches is pertinent in

the solution of most appraisal problems; their application is well established in appraisal technique and held to be part of the fundamental process.

United States v. Eden Memorial Park Ass'n, 350 F.2d 933, 935 (9th Cir. 1965) (citing *The Appraisal of Real Estate* (1964).

II. The Courts are Split on the Use Of the Income Method for Valuing Undeveloped Land Where the Highest and Best Use is as an Income-Producing Property

Even though all three appraisal methods are typically used by appraisers, developers, and investors to value land, the courts are inconsistent in allowing experts to use the "income approach" in the courtroom. Some courts have stated that the income method is speculative when applied to undeveloped land, and apply the strict standard that there must be **no** evidence of "market value" using comparable sales. *United States v. 3,727.91 Acres of Land*, 563 F.2d 357 (8th Cir. 1977); *United States v. 819.98 Acres of Land*, 78 F.2d 1468 (10th Cir. 1996). *See also, Fruit Growers Express Co. v. City of Alexandria*, 221 S.E. 2d 157 (Va. 1976); *Allison v. Ticor Title Ins. Co.*, 979 F.2d 1187 (7th Cir. 1992) (interpreting Wisconsin law).

Other courts, however, consider the income method to reflect current appraisal practice and admissible to establish fair market value, and allow it to be used even if there are comparable sales or the sales are questionable. *United States v. 25.406 Acres of Land*, 172 F.2d 990 (4th Cir. 1949), *cert. denied*, 337 U.S. 931 (1949); *Eden Memorial Park Ass'n*, 350 F.2d at 935; *City and County of Honolulu v. Bishop Trust Co.*, 404 P.2d 373 (Hawaii, 1965); *Dash v. State of Alaska*, 491 P.2d 1069 (Ala. 1971); *Ramsey v. Miller*, 316 N.W. 2d 917 (Minn. 1982). At least one court has stated that fears of speculation are diminished, not enhanced, with modern precise and analytical methods. *Ramsey*, 316 N.W. 2d at 921.

The rejection and acceptance of the income method have been referred to as the former rule and the modern rule,

respectively. 5 Nichols' on Eminent Domain, sec. 19.01[2] 1993. In accepting the modern rule, the Minnesota Supreme Court has emphasized the importance of analytical methods in determining the price that a buyer would pay for land, stating:

> With the use of computers, sophisticated buyers and sellers are able to consider accurately a myriad of variables in arriving at a current market value for undeveloped land. The factors involved in the development cost approach are clearly those that are "brought forward" and given "substantial weight" in "fair negotiations" between a willing seller and a willing buyer.

Ramsey, 316 N.W.2d at 922. The court's rationale in *Ramsey* is based on the underlying constitutional principle that other measures of value are relevant as bearing on what a prospective purchaser would have paid, a guiding principle established by the United States Supreme Court in many cases. *E.G., Toronto, Hamilton & Buffalo Nav. Co.*, 338 U.S. at 402, as well as modern evidence rules, which allow the broad admissibility of evidence bearing on value, and on current practices in real estate. *Ramsey*, 316 N.W.2d 917 at 922.

The Minnesota Supreme Court ruled that the income method (called cost approach in this case) was appropriate on a fact pattern very similar, and identical in principle, to the present case. *Ramsey*, 316 N.W.2d 917. In *Ramsey*, the county of Ramsey's appraisers relied on "comparable" sales to value a large parcel of undeveloped condemned land that had as its highest and best use residential development. On cross-examination, it was revealed that the "comparable" parcels lacked desirable features of the condemned land. The condemnee's experts testified that the "comparables" were too dissimilar to determine market value. The trial court did not allow the condemnee's experts to testify to the bases of their opinion of value based on the income (development cost) method, saying that this type of testimony is "inherently speculative" when the property is undeveloped land. The

Minnesota Supreme Court overruled. The Court explained that the development cost approach is designed to reflect, through cash flow analysis, the current ***price a purchaser would pay*** for the land, given the cost of developing it and the probable proceeds from the sale of developed sites. *Id.* at 920. (emphasis added)

Similarly, the Fourth Circuit Court of Appeals has also upheld the use of the income method for undeveloped land where the highest and best use was as an apartment complex. *United States v. 25.406 Acres of Land*, 172 F.2d 990. The expert testimony using the income method was allowed despite the use of comparable sales by the condemnor. In quoting Henry G. Connor, the court stated:

> It is difficult to perceive why testimony, which experience has taught is generally found to be safely relied upon by men in their important business affairs outside, should be rejected inside the courthouse.

Id. at 993. The decisions by the Minnesota Supreme Court and the Fourth Circuit are consistent with the Uniform Eminent Domain Code. The comment to sec. 1110 states that "the witness may consider either the capitalized actual or *reasonable* net rental income from the property for its highest and best use, if the property is of a kind which is bought and sold on that basis in the relevant market." Uniform Eminent Domain Code, sec. 1110, p. 15 (1975)

The Nebraska Supreme Court is inconsistent in how it has treated the "income approach" in valuing undeveloped land. In a recent 1996 decision, the Nebraska Supreme Court approved the development of the "income approach" for farm land where the landowner testified that the highest and best use was as a recreational vehicle (RV) park and used rents from an RV park in Iowa as a basis for his opinion as to value. *McArthur v. Papio-Missouri Nat. Res. Dist.*, 547 N.W. 2d 716 (Neb. 1996). The Nebraska Supreme Court has similarly approved the use of the income method in other cases where the use was

"recreational" even when the anticipated use was remote in time from the condemnation. *Iske v. Metropolitan Utilities Dist. of Omaha*, 157 N.W.2d 887 (Neb. 1968); and the condemnor's experts used the market data method using adjusted comparable sales. *Iske v. Omaha Public Power Dist.*, 178 N.W. 2d 633 (1970).

Other courts have interpreted *Iske* cases to stand for the proposition that value of undeveloped land determined by the income method is admissible in a condemnation action and do not limit it to recreational uses. The Nevada Supreme Court, in relying on the holding in *Iske v. Metropolitan Utilities Dist.*, stated that the income method was admissible to value undeveloped land because "sophisticated investors make decisions on the basis of capitalization of income." *Tacchino v. State of Nevada*, 508 P. 2d 1212 (1973). The Supreme Court of Alaska found the reasoning in the *Iske* cases persuasive, and ruled that the income method was appropriate for valuing land with a highest and best use as an industrial development, even though there were comparable sales. *Dash*, 491 P.2d at 1074

The Minnesota Supreme Court has established the following criteria for introducing the development cost approach (income method):

> ... the party introducing such evidence can lay a proper foundation to show that (a) the land is ripe for development; (b) the owner can reasonably expect to secure the necessary zoning and other permits required for the development to take place; and (c) the development will not take place at too remote a time.

Ramsey, 316 N.W.2d 917 at 922. Clearly, Patterson's land meets these strict criteria. The land had recently been cleared. Mr. Patterson, an experienced design draftsman in large-scale precast and prestressed concrete construction, had drawn plans. The land was zoned for high-density apartments, and the declining interest rate and low vacancy rate in the area, coupled

with initiation of development on the immediately adjacent multi-million dollar Beadle Biotechnology Center, signaled a climate ripe for development.

a. The Income Method to Value Land Reflects How a "Willing Buyer" Would Determine Purchase Price

Market value is determined by what a willing buyer would pay a willing seller. *E.G., Miller*, 317 U.S. at 374. The willing buyer for a large-scale investment property is a major investor. Assembled property is likely to be sold on a national (not local) market. Once the willing buyer has been identified as a large investor, the analysis turns to how the willing buyer would determine the purchase price. The willing buyer of an assembled urban property will look at the property from the perspective of the rents that would be derived from developing the property in its highest and best use. Rents are determined by comparing rents throughout the area, the vacancy rate, and prospective changes in the area. In the present case, the zoning, the plummeting interest rate, higher rents in the area surrounding the university than in other areas of the city, 1.5% vacancy rates, and the development of the Beadle Biotechnology Center were among the factors that a willing buyer would have considered. The construction of the Beadle Research Center was not part of the public taking, and Patterson should have been allowed to reap the benefits of increased value due to the imminence of its construction.

A major investor will likely turn to a series of successively more detailed income capitalization-based analyses of prospective development of the land. The income method provides the most accurate estimate of value from a large number of input parameters that buyers and sellers take into consideration when negotiating a price for property, and the use of numerical analysis and computers are now routine in development and construction.

In the present case, Patterson and two licensed real estate appraisers were qualified as experts, and would have provided

testimony based on the most accurate possible application of the income method, discounting back to the condemnation date cash flows into and out of the development schedule based on a fully bid set of professionally stamped architect's plans for the development. Patterson, who has expertise in telecommunications and computer technology, had developed a spreadsheet that allowed sophisticated input parameters for developing his land.

The so-called "net present value" of the cash flows is the sum of the discounted cash flows into the project net of the discounted cash flows out, discounted to a particular date (the condemnation date). With the cost of the land being represented as just another cash flow out of the project schedule, the value of the land is that cash flow out for land which makes the "net present value" of the project zero. At this point the willing buyer is earning the appropriately calculated discount rate on all monies which he has put into the development. If he pays more he would earn a lower rate, and would look to alternative investments on which an appropriate rate of return on investment may be obtained.

If allowed to offer an opinion of value relying on the income method, Patterson and his experts would have also explained the following, as checks of the computer spreadsheet net present value model, and checks for the reasonableness of "comparables" offered in opposition to it:

a. A reasonable "rule of thumb" for the sale price of land near the date of buildability of a large-scale development in an intensely developed area where land is scarce and demand is high, and there is no threat of condemnation, is that the land value should be 10% to 20% of the finished project cost including land, labor, materials, construction period interest, etc.

Two properties in downtown Lincoln, Nebraska served as examples of high end estimates on total development cost. During the distressed period of the 1980's, Windsor Place and

University Towers in the Remodeled 1930's Stuart Building, one block south of the University campus managed to sell units well into the $120,000 range.

On the low end three story, stick built, low amenity, minimally architected building plans were thrown into uncleared sites of opportunity in the same general area south, east, and west of the campus and the downtown office district costing from $30,000 to $60,000/unit near the time of condemnation.

The reasonable range, depending on amenities, that Patterson identified for his thoroughly bid architectural and engineering plans presented at trial, lay within this range. at $50,000/unit to $75,000/unit, in five-story precast concrete buildings achieving the full zoned density with required parking, open space, side yards, etc. ***The share attributable to land of the project cost at 10% would yield a reasonable range of $5,000 to $7,500/ unit or at 20%, $10,000 to $15,000/ unit.*** The higher end of the percent range is appropriate given the excellent location on the immediate edge of the Beadle Research Center.

Based on the type of estimates that investors make, the verdict clearly does not indemnify Patterson for his loss. The jury verdict of $1,900/unit is only 3% of a $60,000 unit. The fact that the jury verdict was within the range of testimony is only because the testimony used sales that did not reflect "market value."

b. Another method yielding a lower bound on value is to capitalize any rental increment attributable solely to the situs value of the land. Mr. Hassebrook, Patterson's first licensed real estate appraiser did a study of rents in the Lincoln area and found that proximity to the University campus increased rents approximately $100/month. Using that rental data, he would have testified to the value of Patterson's land using the income method.

Figuring that rental raises factor out the inflation rate, and assigning 4% for the real rate and 6% for the risk rate, we discount conservatively 11 months situs increment a year at 4% + 6% = 10% resulting in ***$11,000 in "net present value"/unit inherent solely in the situs characteristic of the land.*** (For a more thorough explanation of this method see 'Location' under 'Summary of Error Types Cited' in Appendix B.)

c. ***Lower bounds*** can also be determined from sales, even though the sales are inferior to the condemned property. Using three recent sales presented at trial:

1. The fifth and sixth of six 50' wide lot purchases on the only other land assembly sequence done in the 1980's in the neighborhood, terminating in 1989, prior to buildable interest rates, were separately concluded with unadjusted acquisition costs of $5,500/unit and $7,300/unit, respectively, in an inferior location three blocks further east of the campus. Taken by themselves, each may serve as one of several unrelated lower bounds on per unit value. Taken together, time value of money discounting techniques may be used to show that each was part of a single extended property acquisition sequence where the buyer's target price for the time of buildability was about $7,000. (Time sequence sale analysis is covered in Appendix B under "Purchase Price Not Discounted to Time of Buildability.")

2. The Claremont sale, a "special permit" parcel, sold at $4,000/unit was a mile northwest of the campus across rail yards and backed up against a creek with distinct odor. Zoning allowed only two stories, as opposed to the five stories allowed on the R6 zoning on Patterson' land.

III. When the Landowner In An Urban Development Condemnation Is Not Made Whole, He Is No Longer in a Position to Reinvest In Equivalent Property, His Wealth Is Redistributed To Special Interest Groups, And His Constitutional Guarantee of Just Compensation Has Been Denied

The power of eminent domain should not make some men poor, and redistribute the wealth of the politically powerless to politically powerful "rent-seekers." The prosperity of our society depends upon hard work and investment, and upon the example set when those engaging in it are visibly rewarded by the fruits of their labors. By guaranteeing people a fair price for land taken, we encourage work, saving, and investment "by providing security for the fruits of economic endeavors." Frank I. Michelman, *Takings*, 1987, 88 Colum. L. Rev. 1600, 1625-29 (1988).

If a man spends 18 years of arduous work in a well-planned investment strategy setting up the land and technological infrastructure for a job-producing, high bandwidth communications and computing oriented, office residential-technology development in the inner city, just compensation should be ***actual value*** for the highest available and most profitable use for which it was adaptable at the time of taking. To make it otherwise is to reward hard work with poverty, in the most public possible way.

The administration of just compensation by the courts has come under criticism by some commentators because it does not award "consequential" damages. The greater evil, however, is that the landowners in eminent domain actions are not being fairly compensated for their property. The redistribution of land in America, particularly following urban renewal projects is great, and the increasing poverty in America is attributable, in part, to this redistribution of land. Charles C. Geisler, *Land and Poverty in the United States: Insights and Oversights*, 71 Land Economics (1995).

It sometimes happens that private plans conflict with the plans of urban developers, who may utilize the land in a different and decidedly less valuable way than the condemned landowner. Most commonly there are beneficiaries of the "taking," which seldom include the individuals who have "been taken," since they are seldom the chosen developer, architectural

firm, or real estate agent that secures profits from the government action. "Just compensation" leaves the landowner without adequate resources. Whether she be a resident or investor, she is left in the situation where she cannot replace the property because she does not have the "cash" to purchase equivalent property. This kind of situation violates the basic equitable principles of the Just Compensation Clause, which is to indemnify the landowner. It is manifest injustice.

It should be of no surprise if private investment in inner cities disappears, or can be accomplished only with significant government subsidies. The risk of condemnation will chill, if not quell private investment. The United States is not operating under the burden of excess private savings and investment, particularly in its inner cities (such as the condemnation in this case). Fears that adequate compensation will hedge risky investments is not realistic. *See, e.g.*, William K. Jones, *Confiscation: A Rationale of The Law of Takings*, 24 Hofstra Law Rev 1, (1995) 1-12.

Bureaucrats may seek to increase the number of projects in their portfolios even though funds are insufficient to cover all of their plans. In that case, they are presented with the choice of confiscation of private wealth, often from the poor in the name of the poor, or finding more efficient ways to utilize funds. The Luedke report (E20) gave the City of Lincoln a choice, and the City of Lincoln chose delayed confiscation from a private land assembler rather than the course of assembling the property on their own. One of the purposes of just compensation is to redistribute the economic loss so that it will fall upon the public rather than upon those who "happen to lie in the path of the project." *Willow River Co.*, 342 U.S. at 502.

IV. The Nebraska Supreme Court Ruling Is Wrong

The Supreme Court's ruling is wrong. The "comparables" used by the City's appraisers, were too dissimilar to determine "market value" and were not properly adjusted to reflect fair market value at the time of taking. In the Nebraska Supreme

Court opinion, it was stated that the City of Lincoln's first appraiser, Mr. Frost, adjusted the sales to comply with standard appraisal practice. He did not. Mr. Frost readily admitted that he did not adjust any sales, for either time, location, improper, zoning, density, even if they were not arm's lengths transactions. (240:2; E22) This is an error of law and an error of fact.

Comparable sales, as a matter of law, must be comparable. Sales are not comparable just because the condemnor's appraiser says they are. When sales cannot determine market value, the landowner is not indemnified, it is manifest injustice, and other measures of value must be used. That is a well-established principle. *Miller*, 317 U.S. at 369; *Olson*, 292 U.S. at 246. The court erred in admitting evidence based on comparables that were not ***in fact*** comparable. The court erred in not allowing Mr. Patterson and his real estate appraisers to testify to the value of the condemned land using the income method. The ruling is inconsistent with the principles elucidated by the United States Supreme Court, the modern approach to valuation used by investors and appraisers, and modern evidence rules.

The court made a substantial factual error by stating that the condemnor's appraisers properly adjusted the sales distant in time, location, zoning, and other matters. The sales were not properly adjusted. (E22, E37) The best evidence of value using comparable sales, are those closest to the time of taking. *United States v. 100 Acres of Land*, 468 F.2d 1261, 1265 (1972), *cert. denied*, 414 U.S. 864 (1973). It is always possible to find numerous sales of land if the sales need not be "true comparables." The appraisers omitted sales that demonstrated an increase in market value. Mr. Wilson admitted that he omitted using the sales closest in time to the taking because his market research in the subject neighborhood was done prior to these sales being filed. (322:7-13)

These errors deprived Patterson of his constitutional right to just compensation. The jury verdict of $1900/unit was manifestly unjust because the compensation was distinctly lower

than actual value. Patterson was not put in the same position financially as he was before the taking. He was not made whole, in any sense of the word.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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